LIBRARY
SUPREME COURT. U. S.

No. 237

Office - Supreme Court, U.S.
FILED
JUL 30 1958
JOHN T. FEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM 1958

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.,

Petitioner,

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA,

and

THE EQUITY ANNUITY LIFE INSURANCE COMPANY,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

JOHN H. DORSEY,
Counsel for Petitioner,
1741 K Street, N. W.,
Washington 6, D. C.

Of counsel:
POWELL, DORSEY, BLUM & WHITE,
1741 K Street, N. W.,
Washington 6, D. C.

ROMAN TIMES LAW PRINTERS

INDEX.

	PAGE
Opinion below	2
Jurisdiction	2
Question presented	2
Statutes involved	2
Statement	3
Reasons for granting the writ	10
Conclusion	17
Appendix A—Statutes	18
B—Opinion and judgment below	31
C—Excerpt from 1956 Proceedings of the National Association of Insurance Commissioners (Semi-Annual Meeting)	42

CITATIONS.

Cases:

American Hospital and Life Insurance Co., No. 436, decided by this Court on June 30, 1958	10
Booth v. Ammerman, 4 Bradf. Surr. 129, 133, 134 (N. Y. 1856)	12
Coastal States Life Insurance Co. v. Kelly, Court of Common Pleas, Richland County, S. Car., June 1955, unreported	9
Drake v. United States *ex rel.* Bates, 30 App. D. C. 312 (1908)	13
F. T. C. v. National Casualty Co., No. 435, decided by this Court on June 30, 1958	10
Helvering v. Le Gierse, 312 U. S. 531, 539-540 (1941)	8, 11, 13
Jordan v. Group Health Ass'n, 107 F. 2d 239, 244-5 (D. C. Cir. 1939)	8, 13
Keller v. Commissioner of Internal Revenue, 312 U. S. 543, 544 (1941)	11

PAGE

SEC v. C. M. Joiner Leasing Corp., 320 U. S. 344 (1943) 10

SEC v. W. J. Howey Co., 328 U. S. 293 (1946) 10, 11, 17

Spellacy v. American Life Insurance Association, 144 Conn. 346, 131 A. 2d 834 (1957) 9, 14

State of West Virginia *ex rel.* Edgar B. Sims, its Commissioner of Securities v. Variable Annuity Life Insurance Company of America, Inc., pending in the Circuit Court of Kanawha County, West Virginia, Docket No. 24,449 16

Statutes:

Act of June 6, 1934, 48 Stat. 881, as augmented by Act of June 25, 1938, § 1, 52 Stat. 1070, 15 U. S. C. § 78o-3 3

Investment Company Act of 1940 (Act of August 22, 1940, 54 Stat. 789, 15 U. S. C. § 80a-1) 2

§ 1 17

§ 1(a)(1)-(5), (b)(1)-(8) 21

§ 2(a)(21) 2

§ 2(a)(17) and 3(c)(3) 3, 15, 24

§ 3(a) 15, 25

§ 7 .....3, 25

§ 8(a) 26

§ 24(a) 27

§ 42(e) 28

§ 44 .....3, 29

McCarran-Ferguson Act (Act of March 9, 1945, 59 Stat. 33, as amended, 15 U. S. C. §§ 1011-1015) ..2, 3, 8, 10, 15, 29

Securities Act of 1933 (Act of May 27, 1933, 48 Stat. 74, as amended, 15 U. S. C. § 77a) 2, 18

§ 2(1) 2, 10, 18

§ 3(a) 19

§ 3(a)(8) 3, 11, 15, 19

§ 5(a)(1) and 5(c) 3

§ 5(a)(1)(2), (b)(1), (c) 19

§ 20(b) 20

§ 22(a) 3, 20

PAGE

Securities Exchange Act of 1934, as amended § 15A... 3

Uniform Securities Act (Vol. 9C of the Uniform Laws Annotated)

§ 401(1) 9

§ 402(a)(5) 9

28 U. S. C. § 1254 (1) 2

Miscellaneous:

Bellinger, *et al.*, "The Meaning and Usage of the Word 'Annuity'," 9 Journal of the American Society of Chartered Life Underwriters 261 (1955) 12

IN THE

Supreme Court of the United States

OCTOBER TERM 1958

No. .....

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.,

Petitioner,

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA,

and

THE EQUITY ANNUITY LIFE INSURANCE COMPANY,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

National Association of Securities Dealers, Inc. (NASD), prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the District of Columbia Circuit, entered in the above-entitled case on May 22, 1958.

Citation to Opinions Below

The opinion of the District Court (R. 82) is reported in 155 F. Supp. 521. The opinion of the Court of Appeals (R. 885), printed in Appendix B hereto, *infra,* p. 31, is reported in F. 2d .

Jurisdiction

The judgment of the Court of Appeals was entered on May 22, 1958 (R. 895) and is printed in Appendix B hereto, *infra,* p. 40. The jurisdiction of this Court is invoked under 28 U. S. C. § 1254 (1).

Question Presented

Whether "variable annuity" contracts within the definition of "security" as defined in § 2(1) of the Securities Act of 1933; and whether the issuers of such contracts within the definition of "Issuer" in § 2(a) (21) of the Investment Company Act of 1940, are exempted from compliance with the provisions of said Federal statutes because the "Issuer" is: (a) chartered by a state or the District of Columbia as an insurance company; and, (b) a State or District of Columbia administrative officer or agency declares that the contracts are "insurance" notwithstanding that the contracts do not possess what this Court has held are "elements * * * essential to a life insurance contract * * *."

Statutes Involved

Statutes involved are the Securities Act of 1933 (Act of May 27, 1933, 48 Stat. 74, as amended, 15 U. S. C. § 77a); the Investment Company Act of 1940 (Act of August 22, 1940, 54 Stat. 789, 15 U. S. C. § 80a-1) and the McCarran-Fer-

guson Act (Act of March 9, 1945, 59 Stat. 33, as amended, 15 U. S. C. §§ 1011-1015). Pertinent provisions of these statutes are printed in Appendix A hereto, *infra*, p. 18.

Statement

This action was instituted by the Securities and Exchange Commission (SEC) to enjoin Variable Annuity Life Insurance Company of America (VALIC) from violating the registration provisions of the Securities Act[1] and the Investment Company Act.[2] The District Court had jurisdiction of the action by virtue of § 22(a) of the Securities Act of 1933 (15 U. S. C. § 77v(a)) and § 44 of the Investment Company Act of 1940 (15 U. S. C. § 80a-43). On their own motions NASD, petitioner herein, and the Equity Annuity Life Insurance Company (EALIC) intervened on the sides of the plaintiff and defendant, respectively. The NASD is a duly organized national securities association registered with the SEC (5 S. E. C. 627 (1939)) having and administering powers in the over-the-counter securities market conferred by § 15A of the Securities Exchange Act of 1934, as amended.[3] VALIC and EALIC alleged as affirmative defenses § 3(a)(8) of the Securities Act exempting insurance and annuity contracts (15 U. S. C. § 77c(a)(8)); §§ 2(a)(17) and 3(c)(3) of the Investment Company Act exempting insurance companies (15 U. S. C. §§ 80a-2(a)(17) and 80a-3(c)(3)); and, lack of SEC authority because of the provisions of the McCarran-Ferguson Act (15 U. S. C. §§ 1011-1015). The material facts (R. 115-299) are not in dispute and may be summarized as follows:

---

[1] Sections 5(a)(1) and 5(c) of the Securities Act of 1933, 15 U. S. C. §§ 77e(a)(1) and 77e(c).

[2] Section 7 of the Investment Company Act of 1940, 15 U. S. C. § 80a-7.

[3] Act of June 6, 1934, 48 Stat. 881, as augmented by Act of June 25, 1938, § 1, 52 Stat. 1070, 15 U. S. C. §78o-3.

VALIC and EALIC are chartered as stock insurance companies in the District of Columbia. Their principal business is the sale of contracts labeled with the coined name "variable annuity."[1] This novel contract first came into being in 1952 (R. 490).

The purchaser of a variable annuity contract, whom we shall refer to as the investor (referred to in the contract as the "annuitant"), agrees to make certain specified periodic payments to VALIC during a stipulated period from ages 0 to 70 years.[2] After deducting loading charges for expenses and profits the net remaining from each payment is invested by VALIC in an investment fund, consisting almost exclusively of common stocks, for the account of the investor. This fund is exclusively managed, controlled and operated by VALIC, the promoter. At the time of each payment the investor is credited with a number of shares in the fund (referred to in the contract as "accumulation units"), determined by dividing the current value of shares at the time of payment into the net payment. The contract provides that each year VALIC shall notify each contract holder of the total number of shares ("accumulation units"), determined by dividing the current value of shares at the date of notification. The value of the shares fluctuates with the promoter's (VALIC's) investment experience. Throughout the period during which the investor is making periodic payments he may, at any time, cash in his shares at current value as a result of which he may realize

---

[1] The Court of Appeals found that "although VALIC sells what are undoubtedly life insurance contracts, they are tied in with its 'annuity' contracts and are a small part of its total business." (App. B, p. 34.)

[2] VALIC sells numerous types of contracts involving the same investment principle. The contract (R. 567) herein described is sold by VALIC and is entitled "Deferred Variable Annuity Policy." It was received in evidence as a specimen of all the contracts that employ such investment practice (R. 84). EALIC stipulated that its contracts were in all material respects the same as those issued by VALIC (R. 84).

a profit or loss (this the contract calls "cash value"). The investor may also cash in a portion of his shares at current value (this the contract calls a "policy loan"). However, if he reinvests (repays) what the contract terms a "policy loan" he does not receive the same number of shares he cashed in. Instead, his "repayment" purchases shares at their current value as of the date of "repayment." There is no life contingency involved in this pay-in period. All during this period the elements of a profit-seeking venture are present. The investors provide the capital, share in the earnings and profits, and are saddled with the risk of loss resulting from investment of their funds by the promotor (VALIC).

The contract does not obligate the investor to participate in the investment fund to any further extent than that set forth above. The "variable annuity" contract does, however, give the investor an election to purchase a so-called "variable annuity" between the ages of 50 and 70 years. If he so elects he makes a capital contribution to VALIC equal to the number of shares ("accumulation units") which he has purchased times the then current value of a share.[1] For each $1000 of said contribution he is guaranteed a *first* monthly payment of something less than $10 per thousand paid in, computed on the basis of the Progressive Annuity Mortality Table at 3½% interest. After the first payment he is guaranteed (assured) no specific, *or even any,* monthly payment. Instead, he is credited with a number of shares

[1] From the inception of the contract up to the date of election the investor cannot know what capital he will have acquired for he cannot foresee how many shares ("accumulation units") he will have purchased or their value as of the date of election. VALIC stands legally indifferent whether the value of all shares acquired is at that time less or more than the total amount invested. The investor has only the hope that VALIC's management, operation and control of the investment fund in which he has an aliquot share will result in a profit and not a loss.

(called "annuity units") in the investment fund.[1] The future value of these shares ("annuity units") is speculative in that *all* monthly payments to the investor subsequent to the first are computed by the formula number of shares times the current monthly value of the share resulting from VALIC's operation, management and control of the investment fund. Before the investor's interest is made manifest, VALIC deducts, as prior charges, a management fee (1.8% per annum) and taxes (undescribed in the contract). The investor is paid each month for life or other optional term the uncertain future current monthly value of a share ("annuity unit"), *if any*, times the shares credited to his account. The investor has only the hope of gain and bears the risks of loss. He has no voice in VALIC's management, control or operation of the investment fund, and no control of its resulting investment experience.

Purchasers of the contract are attracted by the expectation of substantial profits. VALIC's sales literature (R. 745-804) describes the scheme as: "* * * a way to provide inflation-proof retirement * * *" (R. 749); a "* * * plan * * * to provide a purchasing power income * * *" (R. 750). The contract contains no guarantees (assurance) of such results; it does not even mention them.[2] Further, the litera-

---

[1] "Annuity units" credited to the purchaser's account are determined by dividing the first month's guaranteed payment to him by the current value of such a unit. The number of units remains constant for the balance of the term of the contract. One who elects to purchase a "variable annuity" contract when the value of an "annuity unit" is low will have more such units credited to his account than another making the same capital investment under the same contract when the value of the unit is higher. The former, owning more shares, will receive larger payments than the latter in the same month although each has invested an identical amount of dollars.

[2] EALIC, in a pamphlet entitled "EQUITY ANNUITY—a new road to SECURITY," says:

> "Our variable annuity program is designed to minimize the speculative features of common stock investments. You avoid the gamble of buying a single stock * * * the Company 'spreads the risk' by buying stocks in *many* of the nation's leading corporations * * * You avoid the risk of buying stocks at one point in the stock market * * * You avoid buying stocks on a 'hot tip'. Instead you benefit from the counsel of expert financial advisers * * * In short you get the benefit of expert diversification." (Pls. Exh. 17, not printed in Joint Appendix.)

ture implies that through VALIC's investment management of the fund the investor will receive a greater amount of dollars in return than would a purchaser of an annuity. This the contract does not guarantee. The literature omits to inform of losses which the investor may incur because of possible poor investment management or market fluctuations having no relationship to the costs of living or the purchasing power of the dollar.

The District Court found that:

> "74. A VALIC and an EALIC contract holder invests money with the respective defendants with the hope or expectation that a profit will accrue to him as a result of the management of the portfolio of securities purchased by VALIC and EALIC with the money invested by the contract holder, and his expectation of profit based upon the efforts of others applies to both the 'accumulation period' and to the repayment or variable annuity period" (R. 109-110).
>
> "49. The risk of profit or loss on investment is borne by the contract holders" (R. 108).
>
> "94. The distinguishing and predominant nature of a variable annuity is found in its provision for sharing profits and losses in a common fund to be invested mainly in common stocks" (R. 111).

In its opinion the District Court stated that "The logic of the law applied to the established facts seems to bring the variable annuity contract within the purpose and intendment of the Securities Act, and the defendants within the terms and plan of the Investment Company Act" (R. 89). It so found as a conclusion of law (R. 112). Without making a finding that the variable annuity contract is "insurance" and its sale "the business of insurance" the District Court denied the injunction because VALIC and EALIC were chartered as insurance companies and their variable annuity contracts had been approved by the Insurance Superintendent of the District of Columbia and by the insurance

departments of three States (West Virginia, Kentucky and Arkansas). From this premise the Court reasoned that the provisions of the McCarran-Ferguson Act exempted the contract and its sale from compliance with the Federal securities laws (R. 90-91, 112).

The Court of Appeals recognized that:

> "* * * the most important risk that the purchaser desires to shift when he buys an annuity is the risk that he will live longer than his funds will last."

It then went on to show that this risk *is not shifted* by the variable annuity contract by saying:

> "The appellants urge that VALIC policy holders, like investors in investment companies, may lose their savings and ultimately fail to receive the protection which they hoped to buy when they paid their premiums. That fact seems to us to be inherent in the nature of this experiment in annuity contracts" (App. B, *infra*, pp. 38-39).

The Court of Appeals refused to apply this Court's determination that when the Congress employed the term "insurance" in a statute without definition it used the word "in its commonly accepted sense" and that:

> "Historically and commonly insurance involves risk-shifting and risk-distributing * * * That these elements of risk-shifting and risk-distributing are essential to a life insurance contract is agreed by courts and commentators." *Helvering v. Le Gierse*, 312 U. S. 531, 539-540 (1941).[1]

In affirming the District Court in an opinion unsupported by reference to case law or authorities it failed to find or hold that the variable annuity contract is "insurance" or an "annuity." Instead, it found that the sale of variable annuity contracts is a "new business" which "*resembles* insurance"[2] (App. B, *infra*, p. 39). The Court of Ap-

[1] It also failed to apply a similar test of the indispensable elements of an insurance contract set forth in its opinion in *Jordan v. Group Health Ass'n*, 107 F. 2d 239, 244-5 (D. C. Cir. 1939).

[2] Italics supplied.

peals, paying no heed to the substance of the contracts, attached controlling weight to approval of them by the Superintendent of Insurance for the District of Columbia and insurance commissioners of three states (App. B, *infra*, pp. 37, 39). It disregarded cases cited by SEC and NASD in which the insurance authorities for the states of Connecticut and South Carolina had rejected similar investment schemes as insurance and were sustained by the courts. *Spellacy v. American Life Insurance Association*, 144 Conn. 346, 131 A. 2d 834 (1957); *Coastal States Life Insurance Co. v. Kelly*, Court of Common Pleas, Richland County, S. Car., June 1955, unreported. The Court did not indicate that it had given any consideration to the expert opinion of the SEC that the contracts are securities. It disregarded that recognized leaders in the insurance industry are divided on the question as to whether variable annuity contracts are insurance and a proper product to be offered by life insurance companies. See, Appendix C hereto, *infra*, p. 42, 1956 Proceedings of the National Association of Insurance Commissioners, Vol. I, pp. 162-165 (Semi-Annual Meeting).[1] Also, that under existing law such contracts cannot qualify as insurance in many states; e.g., New York, New Jersey, Massachusetts. Instead of adjudicating the legal issue presented as to whether the contracts are in substance a "security" or "insurance" the Court supported its conclusion on its predilection that there is an economic demand for such contracts. Thus it overlooked the issues that the pleadings make clear that the objective of the action is to determine whether the offering and sale of such contracts must comply with the Federal securities laws.

---

[1] The Uniform Securities Act (Vol. 9C of the Uniform Laws Annotated) recently recommended for adoption by state legislatures defines "Security" (§ 401(l)) "so as not to exclude from the definition the so-called 'variable annuities' which have recently been developed." (Quoted from Commissioners' comment on the section.) See also § 402(a)(5) and the Commissioners' comment thereon.

Reasons for Granting the Writ

This is a case of first impression in the Federal courts. It turns on the proper interpretation and application of three important Federal statutes designed to protect the public, the investor and the public interest. The Court of Appeals did not expressly construe these acts. Its decision in effect leaves their interpretation and application to depend on the administrative conclusions of the 48 state insurance commissioners (plus those of the District of Columbia and the territories) as to whether "variable annuities" are "insurance" or "securities." Unless this Court reviews the decision below, the scope of the Federal securities laws will henceforward depend on the determinations of state officials acting under widely differing state laws.[1]

1. In refusing application of the long established judicial definition of the terms "investment contract" and "certificate of interest or participation in any profit-sharing agreement" as used in § 2(1) of the Securities Act, the ruling of the court below conflicts with the decisions of this Court in *SEC v. C. M. Joiner Leasing Corp.*, 320 U. S. 344 (1943) and *SEC v. W. J. Howey Co.*, 328 U. S. 293 (1946).

Disregarding form for substance and emphasizing economic reality, the instant case is not distinguishable in principle from the *Joiner* and *Howey* cases, in which the promoters attempted to disguise investment contracts as leasehold rights and land sales contracts, respectively. This Court has stated that the term "investment contract" "is capable of adaptation to meet the countless and

[1] The exemption from Federal jurisdiction granted in the McCarran-Ferguson Act is limited to "the business of insurance" (App. A, *infra*, p. 29); a phrase, undefined in the Act, which this Court has never construed. The recent cases of *F. T. C. v. National Casualty Co.*, and *American Hospital and Life Insurance Co.*, Nos. 435 and 436, respectively, decided by this Court on June 30, 1958, are inapposite. The issue in those cases was premised on the assumption that respondents were engaged in "the business of insurance." The issue in this case is whether the variable annuity contracts are "insurance" and their issuance and sale "the business of insurance."

variable schemes devised by those who seek the use of the money of others on the promise of profits.'"[1] Also that:

> "'* * * an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise. Such a definition necessarily underlies this Court's decision in Securities Exch. Commission v. C. M. Joiner Leasing Corp., 320 U. S. 344, and has been enunciated and applied many times by lower federal courts.'"[2]

The transactions in this case clearly involve investment contracts as so defined.

2. This case presents a question of exemption from Federal jurisdiction which has not been but should be settled by this Court. The contracts at issue can be exempted from the congressional mandates of the Securities Act only if they come within the meaning of the terms "insurance * * * or annuity contract" as employed in § 3(a)(8) of the Act. The Act does not define these terms. This Court has said that where "insurance" is used undefined in a statute it must be presumed that "Congress used the word 'insurance' in its commonly accepted sense." In the same case this Court held that "risk-shifting and risk-distributing are essential to a life insurance contract * * *"[3] In failing and refusing to apply these tests the Court of Appeals has disregarded the principles established by this Court. The risk which an insurer takes that it will be financially able to fulfill its contractual obligations to the insureds upon the happening of the specified insurable contingency is not an insurance risk. *Keller v. Commissioner of Internal Revenue,*

---

[1] *Howey* case, 328 U. S. at p. 299.

[2] *Howey* case, 328 U. S. at pp. 298-299.

[3] *Helvering v. Le Gierse*, 312 U. S. 531, 539-540.

312 U. S. 543, 544 (1941). An insurance risk is the loss which a person will suffer upon the happening of an insurable contingency; it is that loss which it is *essential* be shifted to the insurer to qualify the contract as insurance. Otherwise stated, if the risk of the loss continues to be vested in the person subject to it, there is no insurance. The risk of loss is not shifted in the variable annuity contract because there is no assurance that the purchaser will have a fixed dependable income, *or any income*, for the remainder of his life. Risk-distribution without risk-shifting cannot be held to be insurance.

The essence of an "annuity," as long established by definition supported by scores of court opinions, is (a) periodic payment of (b) a fixed sum.[1] A typical definition is that set forth in the leading case of *Booth v. Ammerman*, 4 Bradf. Surr. 129, 133, 134 (N. Y. 1856), which has been cited in many decisions:

> "An annuity is a stated sum per annum, payable annually unless otherwise directed. It is not income or profits, nor indeterminate in amount varying according to the income or profits, though a certain fund may be provided, out of which it is to be payable * * * (If a periodic payment) is not a stated sum, but may be more or less, according to the earnings of the capital * * * it does not possess the characteristic of an annuity * * *" (Parenthetical matter supplied).

The Court of Appeals made no finding as to whether the variable annuity contract is "insurance" or an "annuity," a finding which is indispensable to a conclusion of law that the exemptive provision is applicable. It rejected the established principle of statutory construction that words in a statute are used in their commonly ac-

[1] The authorities to this effect have recently been assembled and reviewed at length in connection with "variable annuities." See, Bellinger, *et al.*, "The Meaning and Usage of the Word 'Annuity'," 9 Journal of the American Society of Chartered Life Underwriters 261 (1955).

cepted sense. It abdicated its judicial responsibility to make and enforce an interpretation of existing law. For judicial interpretation and application of the law it substituted administrative opinion which will vary from state to state, including the territories and the District of Columbia, with the personal predilections of each insurance administrator and the non-uniformity of state insurance laws.[1] It would be very strange if, in the absence of an expressed Congressional delegation of authority, the mere declaration by a state administrative officer that a contract is "insurance" were final and binding on the Federal judiciary in its consideration of exemptive provisions of Federal law. Such a view is in conflict with the decision in the *Le Gierse* case, in which this Court found that absent the essential elements of insurance the contracts (a life insurance policy and an annuity contract) were not insurance notwithstanding that, what the facts make clear, the issuer was chartered as an insurance company and the contracts had been approved by a state insurance commissioner. It is also in conflict with the lower court's own decision in *Jordan v. Group Health Ass'n*, 107 F. 2d 239, 244-5 (D. C. Cir. 1939), in which it found that the contract in issue was not "insurance," because it lacked the essential elements of insurance, notwithstanding that the Superintendent of Insurance for the District of Columbia had determined that it was and initiated the action to compel the issuer to comply with the insurance laws of the District of Columbia.[2]

---

[1] For its own purposes a state may by statutory enactment include within a definition of "insurance" whatsoever it may choose. Certainly, when the Congress used the term "insurance," undefined, it did not vest the states with the power to grant exemptions from the Securities Act.

[2] In *Drake v. United States ex rel. Bates*, 30 App. D. C. 312 (1908), the Court of Appeals in referring to the powers of the Superintendent of Insurance for the District of Columbia said:

> "It is quite clear that no provision of the law conferred or attempted to confer upon the superintendent of insurance the power to make and enforce an interpretation of the laws relating to insurance companies . . . Such power is a judicial one, that can be exercised by the courts alone." (30 App. D. C. at pp. 318-19.)

3. The decision is in conflict with a decision of the Supreme Court of Errors for the State of Connecticut in which that court determined that a "variable endowment contract" with a "variable annuity option" was not "insurance" or an "annuity." The case was initiated by the Insurance Commissioner to restrain the issuance of the policy by the defendant, which was licensed by the Commissioner to do business in the state. *Spellacy, Insurance Commissioner v. The American Life Insurance Ass'n,* 144 Conn. 346, 131 A. 2d 834 (1957). Concerning the variable annuity scheme the court said:[1]

> "The variable annuity policy is to be issued 'for such total number of variable annuity units, payable monthly or as may be agreed, as the cash redemption value of the accumulated variable endowment units * * * shall purchase at the initial conversion value of the Variable Annuity Units in effect when the [policy] is issued.' A minimum is fixed at 1000, variable annuity units. The endowment policy recites that '[t]he objective of the contract for Variable Annuity Certificate will be the preservation and increase of the relative purchasing power of the initial dollar value of the annuity units.' In line with this objective, the dollar return from the annuity units would fluctuate with the value and the amount of return from the corpus of the fund from which the annuities are paid. We have said that an annuity is a yearly payment of a certain sum of money granted to another in fee, or for life, or for a term of years, charging the person of the grantor only. It is a stated sum, payable annually. Strakosch v. Connecticut Trust & Safe Deposit Co., 96 Conn. 471, 491, 114 A. 660; Bartlett v. Slater, 53 Conn. 102, 107, 22 A. 678; Commissioner v. Hale, 315 Mass. 556, 558, 53 N. E. 2d 675. Insurancewise, it has the same meaning. 1 Appleman, Insurance Law & Practice, § 81; 1 Couch, Insurance, p. 38. The policy to be issued under the annuity option would provide for the payment, not of a fixed amount of money, but of an uncertain sum, which is quite different from the legal

[1] 144 Conn. at p. 355, 131 A. 2d at p. 839.

concept of the word 'annuity.' Here again, the legislature employed a term generally used and understood, and it must be assumed that it did so intending that annuity payments should be in definite sums of money.'"[1]

4. The ruling of the Court of Appeals introduces a novel and legally unwarranted test under the Securities Act which is administratively impractical.[2] In place of the established legal principle that the legal character of a contract will be judicially determined from its substance the lower court would substitute irrelevant and immaterial criteria such as the type of corporate charter, the corporate name, the label affixed to the contract by the issuer, a layman's unilateral conclusion of law and possible remedy of an economic ill.

If the variable annuity contract is in Federal law to be held "insurance" because a state insurance commissioner says it is, what is it in a state, such as Connecticut, which says it is not? Is it "insurance" in the former; an "investment contract" or a scheme beyond control in the latter? What is it in a state such as West Virginia, the opinion of whose insurance commissioner was

---

[1] The Connecticut insurance statutes do not define the term "annuity."

[2] The complaint alleges that VALIC is an "investment company" within the meaning of that term as defined in § 3(a) of the Investment Company Act of 1940. The resolution of this issue will flow from the judicial determination as to whether the variable annuity contract is an "investment contract" or is exempted because it is an "insurance . . . or annuity contract." Should this Court decide that the contract is exempted by § 3(a)(8) of the Securities Act there is no need to go further. On the other hand, if this Court concludes that the contract is not exempted, and since the issuance of this contract is respondents' principal business, then respondents cannot qualify under the exemption of "Insurance Company" in § 2(a)(17) of the Investment Company Act as their "primary and predominant business activity" would not be "the writing of insurance." Nor is it necessary for this Court to be concerned with the alleged defense of lack of jurisdiction in the SEC by virtue of the McCarran-Ferguson Act. If the contract is "insurance" or an "annuity" it is exempted by express provision of the Securities Act. If it does not so qualify then certainly it cannot be said that Federal jurisdiction has been waived under the limiting phrase "the business of insurance" which is the subject matter of the McCarran-Ferguson Act.

one of those relied upon by the lower court; should that State's Commissioner of Securities prevail in a pending action to enjoin its sale unless VALIC complies with the State's securities laws?[1] Must application and enforcement of the Federal securities law be held in abeyance pending determination by the insurance commissioner of each state as to whether the contract is insurance? We submit that Congress would not and did not leave to the varying whims and economic predilections of individual insurance commissioners, or even state legislatures, the right to determine whether any contract to which they choose to attach the label "insurance" or "annuity" shall be exempted from the provisions of the Securities Act. We do not believe that Congress would leave to implication, uncertainty and conflict such an important segment of the overall question of Federal jurisdiction which it was dealing with when it could easily have been provided for if such was its intention. The test as enunciated by the Court of Appeals is derogatory of the function of the Federal judiciary. It raises an important question of statutory construction of Federal law which should be settled by this Court to avoid a multiplicity of lawsuits and to make certain nationally uniform jurisdiction, administration, application and enforcement of the Federal securities laws. We submit that the Congress did not intend that entities chartered as insurance companies, with their great financial resources, should be permitted to issue, offer and sell securities through the mails and instrumentalities of interstate commerce without compliance with Federal securities law, simply by having a *single* state insurance commissioner, in his administrative capacity, declare that the contract is "insurance." Such a construction should

---

[1] *State of West Virginia ex rel. Edgar B. Sims, its Commissioner of Securities v. Variable Annuity Life Insurance Company of America, Inc.*, pending in the Circuit Court of Kanawha County, West Virginia, Docket No. 24,449.

not be given to an Act of broadly remedial character designed to reach substance rather than form. Cf. the declaration of policy in § 1 of the Investment Company Act (15 U. S. C. § 80a-1).[1]

The decision below would afford a ready method of evading the Federal securities laws. But, this Court has said that: "The statutory policy of affording broad protection to investors is not to be thwarted by unrealistic and irrelevant formulae." *SEC v. Howey*, 328 U. S. 293, 301 (1946). If the principle which the decision below establishes is permitted to stand, corporations chartered as insurance companies may claim exemption from Federal jurisdiction in any field of activity in which they choose to engage if a state insurance commissioner declares that the activity is "the business of insurance."

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

JOHN H. DORSEY,
Counsel for petitioner,
National Association of Securities Dealers, Inc.

August, 1958.

---

[1] App. A, *infra*, p. 21.

APPENDIX A

Pertinent Provisions of Statutes

SECURITIES ACT OF 1933 AS AMENDED

AN ACT

To provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

* * * * *

Sec. 2. When used in this title, unless the context otherwise requires—

(1) the term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

* * * * *

Sec. 3. (a) Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities:

* * * * *

Sec. 3. (a)(8) Any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia;

* * * * *

Sec. 5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

(b) It shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this title, unless such prospectus meets the requirements of section 10; or

* * * * *

(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 8.

* * * * *

Sec. 20. (b) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this title, or of any rule or regulation prescribed under authority thereof, it may in its discretion, bring an action in any district court of the United States, United States court of any Territory, or the United States District Court for the District of Columbia to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. * * *

* * * * *

Sec. 22. (a) The district courts of the United States, the United States courts of any Territory, and the United States District Court for the District of Columbia shall have jurisdiction of offenses and violations under this title and under the rules and regulations promulgated by the Commission in respect thereto, and concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this title. Any such suit or action may be brought in the

district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 225 and 347) * * *

INVESTMENT COMPANY ACT OF 1940

AN ACT

To provide for the registration and regulation of investment companies and investment advisers, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Sec. 1. (a) Upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission made pursuant to section 30 of the Public Utility Holding Company Act of 1935, and facts otherwise disclosed and ascertained, it is hereby found that investment companies are affected with a national public interest in that, among other things—

(1) the securities issued by such companies, which constitute a substantial part of all securities publicly offered, are distributed, purchased, paid for, exchanged, transferred, redeemed, and repurchased by use of the mails and means and instrumentalities of interstate commerce, and in the case of the numerous companies which issue redeemable securities this process of distribution and redemption is continuous;

(2) the principal activities of such companies—investing, reinvesting, and trading in securities—are conducted by use of the mails and means and instrumentalities of interstate commerce, including the facilities of national securities exchanges, and constitute a substantial part of all transactions effected in the securities markets of the Nation;

(3) such companies customarily invest and trade in securities issued by, and may dominate and control or otherwise affect the policies and management of, companies engaged in business in interstate commerce;

(4) such companies are media for the investment in the national economy of a substantial part of the national savings and may have a vital effect upon the flow of such savings into the capital markets; and

(5) the activities of such companies, extending over many States, their use of the instrumentalities of interstate commerce and the wide geographic distribution of their security holders, make difficult, if not impossible, effective State regulation of such companies in the interest of investors.

(b) Upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission made pursuant to section 30 of the Public Utility Holding Company Act of 1935, and facts otherwise disclosed and ascertained, it is hereby declared that the national public interest and the interest of investors are adversely affected—

(1) when investors purchase, pay for, exchange, receive dividends upon, vote, refrain from voting, sell, or surrender securities issued by investment com-

panies without adequate, accurate, and explicit information, fairly presented, concerning the character of such securities and the circumstances, policies, and financial responsibility of such companies and their management;

(2) when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers, investment advisers, depositors, or other affiliated persons thereof, in the interest of underwriters, brokers, or dealers, in the interest of special classes of their security holders, or in the interest of other investment companies or persons engaged in other lines of business, rather than in the interest of all classes of such companies' security holders;

(3) when investment companies issue securities containing inequitable or discriminatory provisions, or fail to protect the preferences and privileges of the holders of their outstanding securities;

(4) when the control of investment companies is unduly concentrated through pyramiding or inequitable methods of control, or is inequitably distributed, or when investment companies are managed by irresponsible persons;

(5) when investment companies, in keeping their accounts, in maintaining reserves, and in computing their earnings and the asset value of their outstanding securities, employ unsound or misleading methods, or are not subjected to adequate independent scrutiny;

(6) when investment companies are reorganized, become inactive, or change the character of their busi-

ness, or when the control or management thereof is transferred, without the consent of their security holders;

(7) when investment companies by excessive borrowing and the issuance of excessive amounts of senior securities increase unduly the speculative character of their junior securities; or

(8) when investment companies operate without adequate assets or reserves.

It is hereby declared that the policy and purposes of this title, in accordance with which the provisions of this title shall be interpreted, are to mitigate and, so far as is feasible, to eliminate the conditions enumerated in this section which adversely affect the national public interest and the interest of investors.

* * * * *

Sec. 2. (a)(17) "Insurance Company" means a company which is organized as an insurance company, whose primary and predominant business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies, and which is subject to supervision by the insurance commissioner or a similar official or agency of a State; or any receiver or similar official or any liquidating agent for such a company, in his capacity as such.

* * * * *

(21) "Issuer" means every person who issues or proposes to issue any security, or has outstanding any security which it has issued.

* * * * *

Sec. 3. (a) When used in this title, "investment company" means any issuer which—

(1) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities;

(2) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or

(3) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis.

As used in this section, "investment securities" includes all securities except (A) Government securities, (B) securities issued by employees' securities companies, and (C) securities issued by majority-owned subsidiaries of the owner which are not investment companies.

* * * * *

Sec. 3. (c) Notwithstanding subsections (a) and (b), none of the following persons is an investment company within the meaning of this title:

(3) Any bank or insurance company * * *

* * * * *

Sec. 7. (a) No investment company organized or otherwise created under the laws of the United States or of a State and having a board of directors, unless registered under section 8, shall directly or indirectly—

(1) offer for sale, sell, or deliver after sale, by the use of the mails or any means or instrumentality of interstate commerce, any security or any interest in a security, whether the issuer of such security is such investment company or another person; or offer for sale, sell, or deliver after sale any such security or interest, having reason to believe that such security or interest will be made the subject of a public offering by use of the mails or any means or instrumentality of interstate commerce;

(2) purchase, redeem, retire, or otherwise acquire or attempt to acquire, by use of the mails or any means or instrumentality of interstate commerce, any security or any interest in a security, whether the issuer of such security is such investment company or another person;

(3) control any investment company which does any of the acts enumerated in paragraphs (1) and (2);

(4) engage in any business in interstate commerce; or

(5) control any company which is engaged in any business in interstate commerce.

The provisions of this subsection (a) shall not apply to transactions of an investment company which are merely incidental to its dissolution.

* * * * *

Sec. 8. (a) Any investment company organized or otherwise created under the laws of the United States or of a State may register for the purposes of this title by filing with the Commission a notification of registration, in such

form as the Commission shall by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors. An investment company shall be deemed to be registered upon receipt by the Commission of such notification of registration.

* * * * *

Sec. 24. (a) In registering under the Securities Act of 1933 any security of which it is the issuer, a registered investment company, in lieu of furnishing a registration statement containing the information and documents specified in schedule A of said Act, may file a registration statement containing the following information and documents:

(1) such copies of the registration statement filed by such company under this title, and of such reports filed by such company pursuant to section 30 or such copies of portions of such registration statement and reports, as the Commission shall designate by rules and regulations; and

(2) such additional information and documents (including a prospectus) as the Commission shall prescribe by rules and regulations as necessary or appropriate in the public interest or for the protection of investors.

(b) It shall be unlawful for any of the following companies, or for any underwriter for such a company, in connection with a public offering of any security of which such company is the issuer, to make use of the mails or any means or instrumentalities of interstate commerce, to transmit any advertisement, pamphlet, circular, form letter, or other sales literature addressed to or intended for distribution to prospective investors unless three copies of the full text thereof have been filed with the

Commission or are filed with the Commission within ten days thereafter:

(1) any registered open-end company;

(2) any registered unit investment trust; or

(3) any registered face-amount certificate company.

(c) In addition to the powers relative to prospectuses granted the Commission by section 10 of the Securities Act of 1933, the Commission is authorized to require, by rules and regulations or order, that the information contained in any prospectus relating to any periodic payment plan certificate or face-amount certificate registered under the Securities Act of 1933 on or after the effective date of this title be presented in such form and order of items, and such prospectus contain such summaries of any portion of such information, as are necessary or appropriate in the public interest or for the protection of investors.

(d) The exemption provided by paragraph (8) of section 3 (a) of the Securities Act of 1933 shall not apply to any security of which an investment company is the issuer. The exemption provided by paragraph (11) of said section 3 (a) shall not apply to any security of which a registered investment company is the issuer, except a security sold or disposed of by the issuer or bona fide offered to the public prior to the effective date of this title, and with respect to a security so sold, disposed of, or offered, shall not apply to any new offering thereof on or after the effective date of this title.

* * * * *

Sec. 42. (e) Whenever it shall appear to the Commission that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this title, or of any rule, regulation, or

order hereunder, it may in its discretion bring an action in the proper district court of the United States, or the proper United States court of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices and to enforce compliance with this title or any rule, regulation, or order hereunder. Upon a showing that such person has engaged or is about to engage in any such act or practice, a permanent or temporary injunction or decree or restraining order shall be granted without bond * * *

* * * * * *

Sec. 44. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder * * *

* * * * * *

McCARRAN-FERGUSON ACT.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled. That the Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

Sec. 2. (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the

several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided,* That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

Sec. 3. (a) Until June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, and the Act of June 19, 1936, known as the Robinson-Patman Antidiscrimination Act, shall not apply to the business of insurance or to acts in the conduct thereof.

(b) Nothing contained in this Act shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation.

Sec. 4. Nothing contained in this Act shall be construed to affect in any manner the application to the business of insurance of the Act of July 5, 1935, as amended, known as the National Labor Relations Act, or the Act of June 25, 1938, as amended, known as the Fair Labor Standards Act of 1938, or the Act of June 5, 1920, known as the Merchant Marine Act, 1920.

APPENDIX B

Opinion

UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 14,253

SECURITIES AND EXCHANGE COMMISSION, APPELLANT

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA, INC., and
EQUITY ANNUITY LIFE INSURANCE COMPANY, APPELLEES

No. 14,254

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., APPELLANT

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA, INC., and
EQUITY ANNUITY LIFE INSURANCE COMPANY, APPELLEES

Appeals from the United States District Court for the District of Columbia

---

Decided May 22, 1958

Mr. Myer Feldman, Special Counsel, Securities and Exchange Commission, with whom *Messrs. Thomas G. Meeker,* General Counsel, Securities and Exhange Com-

mission, and *Pace Reich,* Attorney, Securities and Exchange Commission, were on the brief, for appellant in No. 14,253.

Mr. John H. Dorsey, with whom *Messrs. John W. Lindsey, Bolling R. Powell, Jr.,* and *Edward G. Howard* were on the brief, for appellant in No. 14,254.

Messrs, James M. Earnest and *Roy W. McDonald* of the bar of the Court of Appeals of New York, *pro hac vice,* by special leave of court, for appellee Variable Annuity Life Insurance Company of America, Inc.

Mr. Benjamin H. Dorsey, with whom *Messrs. Smith W. Brookhart* and *Ralph E. Becker* were on the brief, for appellee Equity Annuity Life Insurance Company.

Before WILBUR K. MILLER and DANAHER, *Circuit Judges,* and MADDEN, *Judge,* United States Court of Claims.*

MADDEN, *Judge:* Securities and Exchange Commission, (SEC), brought suit in the District Court seeking an injunction restraining Variable Annuity Life Insurance Company of America, Inc., (VALIC), from selling or offering for sale certain contracts or policies unless and until the contracts or policies were registered with SEC in accordance with section 5 of the Securities Act of 1933, 48 Stat. 74, 77, 15 U. S. C. § 77 (e), and unless VALIC complied with section 7 (a) of the Investment Company Act of 1940, 54 Stat. 789, 802, 15 U. S. C. § 80a-7 (a). On their own motions the National Association of Securities Dealers, (NASD), and the Equity Annuity Life Insurance Company, (EALIC), intervened on the sides of the plaintiff and the defendant, respectively.

The District Court dismissed the complaint, and the plaintiffs have appealed from that judgment. The orig-

* Sitting by designation pursuant to provisions of Sec. 291 (a), Title 28, U. S. Code.

inal defendant and the intervening defendant sell the same kinds of contracts or policies. Those of VALIC will be discussed in this opinion.

The appellees contend that the contracts which they sell and which are the subject of this controversey are annuity policies and are therefore covered by the law relating to insurance, and not by the law relating to securities. They point to section 3 (a) (8) of the Securities Act of 1933, 15 U. S. C. § 77 (c)(a)(8) which says:

> SEC. 3. (a) Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities:
>
> * * * * *
>
> (8) Any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia;

They point to section 3 (c) (3) of the Investment Company Act of 1940, 15 U. S. C. §80a-3(c)(3) which says that an insurance company is not an investment company within the meaning of the Act, and to section 2 (a) (17) of that Act, 15 U. S. C. § 80a 2 (a) (17) which says:

> (a) When used in this title, unless the context otherwise requires—
>
> * * * * *
>
> (17) "Insurance company" means a company which is organized as an insurance company, whose primary and predominant business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies, and which is subject to supervision by the insurance commissioner or a similar official or agency of a State; or any receiver or similar official or any liquidating agent for such a company, in his capacity as such.

They point to the McCarran-Ferguson Insurance Regulation Act of March 9, 1945, 59 Stat. 33; 15 U. S. C. §§ 1011-1015, which says:

> * * * That the Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.
>
> SEC. 2. (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.
>
> (b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided*, That after January 1, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.
>
> * * * * * *
>
> SEC. 5. As used in this Act, the term "State" includes the several States, Alaska, Hawaii, Puerto Rico, and the District of Columbia.

Although VALIC sells what are undoubtedly life insurance contracts, they are tied in with its "annuity" contracts, and are a small part of its total business. If its "annuity" contracts are not annuity contracts within the meaning of the word annuity in the Securities Act of 1933, and within the contemplated business of insurance, as

that word is used in the Investment Company Act and the McCarran-Ferguson Act, the "annuity" label which VALIC places upon its contracts will not avail it.

We lay aside the life insurance feature of the policies, and discuss the annuity feature. In fact, as we understand it, if the applicant for an annuity policy is insurable, for life insurance purposes, he must take at least a five year term life insurance policy. That seems to us to be irrelevant to the question of the nature of the predominant annuity feature of the policy. We will therefore discuss a naked deferred annuity policy such as would be issued by VALIC to one uninsurable for life insurance purposes.

The policy holder agrees to pay a fixed sum of money per year for each year until he reaches the age when his deferred annuity will begin to pay out. A considerable part of what he pays for the first year, and a smaller part of what he pays thereafter are taken by the company for selling and administrative expense and profit. The rest is invested, at the discretion of the company, in securities which, it is hoped, will produce an income or show a capital gain or both. The policy holder is given periodic statements showing what the company has bought with what he and the other policy holders have paid in. These are statements of his "accumulation units." If, for example, the common stocks which the company held at the time the policy holder paid his annual premium were cheap, he would acquire, for the dollars he paid in, a larger number of "accumulation units", since the price or value of the "accumulation units" would be determined by dividing the value of the company's holdings by the number of the units. If thereafter the value of the company's holdings increased, the policy holder would still have the

same number of units, but the value of each unit would be higher. If the value of the holdings decreased, the result would, of course, be the opposite.

Throughout the paying-in period, the value of the policy holders' accumulations would fluctuate with the price of the securities in which the company invested its funds. The policy holder would hope that the long run trend of the prices would be upward. If so, "accumulation units" which he acquired in the early years for $1.00 might be worth $1.50 or $2.00 by the time his deferred annuity came due.

When the time comes for the company to begin to pay the deferred annuity, the policy holder acquires no more "accumulation units" since he will pay no more premiums. The number of "accumulation units" which he has acquired during the years of his payment of premiums will be multiplied by the then value of an accumulation unit, and that dollar amount will be the amount upon which his annuity will be computed. Using the mortality table appropriate to his age and sex, and assuming that 3½ percent interest can be earned upon the funds of the company until they are paid out, the dollar amount, per month, of his annuity is determined, and he is paid that amount for one month. The payments thereafter are determined according to the success of the company with its investments, and may be smaller or larger than the first month's payment. If the value of the "accumulation units", the number of which was fixed when the premium payments stopped, increases, the annuity payments will increase at that time to what they would have been if the units had had that value at the time the first month's annuity had been computed.

The arrangement is, of course, novel. It has been invented in an attempt to obviate the lack of reality of the traditional life insurance and annuity policy in relation to the value of the dollar. Annuity policies bought to provide a living in his latter years for the policy-holder annuitant, and life insurance policies bought to provide for the families of deceased policy holders have proved inadequate because of the decline of the value of the dollar in terms of purchasing power. Persons who have paid for life insurance or annuities have wished that they had bought, instead, tangible things or equities which would have, or might have, kept pace with the inflation of prices. There was room and need for experimentation in an effort to meet this serious problem. The contracts or "policies" offered by VALIC are an experiment in that direction. The question in this litigation is whether these contracts are "insurance" contracts, within the meaning of the statutes quoted above.

The Superintendent of Insurance of the District of Columbia, after due inquiry, issued to VALIC a certificate of authority "to transact within the District of Columbia the business of Life Insurance and Variable Annuities." Insurance Commissioners of three other States have issued similar licenses. The opinion of these officials, charged with the task of careful supervision of the business of insurance to protect the public from imposition, that the business of VALIC is the business of insurance, is important.

Elements of similarity between the "variable annuity" here in question and the traditional annuity may be noted. Both provide that the policy holder may elect at what time between certain stated ages, such as 50 and 70, the annuity payments are to begin. Both provide that the

policy holder may cash in the value of his annuity before annuity payments begin. Both provide a loan value for the annuity contract. Both provide for the payment to beneficiaries in case of the death of the annuitant before annuity payments begin. Both provide that if the policy holder ceases paying premiums, a reduced annuity is nevertheless acquired for the payments he has made. Both provide options whereby payments may continue to another beneficiary after the death of the principal annuitant, and other options. Both have provisions making the annuity payments exempt from the claims of creditors.

It is apparent that the VALIC contract bears many resemblances to a conventional annuity policy. The appellants say that these resemblances are superficial; that the identifying quality of insurance is risk-shifting, and that in the VALIC contracts the policy holder bears his own risk, the risk that the company's investments of his premiums will increase or decrease in value. But perhaps the most important risk that the purchaser desires to shift when he buys an annuity is the risk that he will live longer than his funds will last. If everyone died on the day set for him by the mortality tables, there would be no point in paying an insurance company for doling out one's funds. A savings account, or Government or municipal or good corporate bonds, or a simple trust would do as well. VALIC, by the fact of issuing an annuity policy, does assume the risk of when the annuitant will die. If it does not bear the risk itself, it provides the machinery whereby the risk is shifted from the individual to the group of policy holders.

The appellants urge that VALIC policy holders, like investors in investment companies, may lose their savings and ultimately fail to receive the protection which

they hoped to buy when they paid their premiums. That fact seems to us to be inherent in the nature of this experiment in annuity contracts. Holders of traditional annuity policies in Germany lost all their protection in the inflation of the twenties, and in France nearly all their protection in the post-war inflation. We have already adverted to the situation in this country. Experience in England has been similar.

The statutes which we have quoted above show an unmistakable determination on the part of Congress to leave the insurance business in the control of the States until Congress should in plain terms exert its power over some or all aspects of it. The appellants say that, by definition, the business of the appellees is not insurance. We find no such definition. The definitions in the Securities Act and the Investment Company Act indicate that if the insurance commissioner of a state subjects the business to his supervision, it is the business of insurance. The VALIC contracts have many qualities of the traditional business of insurance. They depart from the tradition only in their attempt to solve a problem badly in need of solution. Unless we confine insurance, by definition, to what has actually been done in the past under the name of insurance, and invent a new and distinctive name for this new business which so greatly resembles insurance, we should not contradict the insurance commissioners. The new business will need the expert and watchful supervision of these experts in insurance. We think the statutes lodge the responsibility with them.

The judgment of the District Court is

Affirmed.

Judgment

UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT.

No. 14,253 April Term, 1958.

SECURITIES AND EXCHANGE COMMISSION, APPELLANT,

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA, INC., and

EQUITY ANNUITY LIFE INSURANCE COMPANY, APPELLEES.

No. 14,254 April Term, 1958.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., APPELLANT,

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA, INC., and

EQUITY ANNUITY LIFE INSURANCE COMPANY, APPELLEES.

Appeals from the United States District Court for the District of Columbia

---

Before: Wilbur K. Miller and Danaher, Circuit Judges, and Madden, Judge, United States Court of Claims.

These cases came on to be heard on the record from the United States District Court for the District of Columbia, and were argued by counsel.

ON CONSIDERATION WHEREOF, it is ordered and adjudged by this Court that the judgment of the said District Court appealed from in these cases be, and it is hereby, affirmed.

It is further ORDERED by the Court that appellees herein recover from appellant National Association of Securities Dealers, Inc., one-half the cost of printing their briefs in these cases, and have execution therefor.

Dated: May 22, 1958.

PER JUDGE MADDEN.

APPENDIX C

1956 Proceedings of the National Association of Insurance Commissioners (Semi-Annual Meeting); excerpt from Volume I:

[162] MEETING OF SUBCOMMITTEE ON VARIABLE ANNUITIES (K5)

The Subcommittee met in the Grand Ballroom of the Commodore Hotel on Monday, November 28, 1955, at 9:15 A. M.

The Chairman announced that this meeting was called for the purpose of giving all interested parties a further opportunity to express their views. The meeting was recessed at 10:15 A. M. with the object of affording Department personnel an opportunity to give further consideration to the problem.

163 SEMI-ANNUAL MEETING

The Committee held a closed meeting with members of the several Insurance Departments at 3:00 P. M. on November 29, 1955.

As a result of such meetings and in order to place the problem of the variable annuity in proper perspective, the Subcommittee directs your attention to the arguments advanced in behalf of and against the issuance of variable annuities by life insurance corporations.

The proponents contend that:

1. the fixed dollar annuity is not adequate to provide a realistic life income after retirement because it cannot reflect changes in the purchasing power of the dollar;

2. the inflationary aspects of the present economy, and the outlook for the continuance of the factors that make for inflation, indicate that this problem will not only remain but may become more aggravated;

3. some responsible organizations now meet this issue by participating in programs outside of the field of insurance without the advantage of the standards inherent in state regulation of insurance;

4. the sale of variable annuities is already in existence and to the extent that experience is available, the program is meeting the hope and promises of its advocates.

The opponents contend that:

1. the strong possibility of misunderstanding on the part of the public might discredit the life insurance industry particularly if a decline in the value of common stock should cause an appreciable lowering of income payment to annuitants, at a time when there is no corresponding increase in the purchasing power of the dollar;

2. the possibility of extending federal regulation to the life insurance industry since the contracts of variable annuities, aside from the mortality aspect, are in most respects identical to the investment contracts now under federal supervision;

3. the risk of placing in further jeopardy the present tax status of life insurance companies and annuities;

4. to the extent that mortality rates and expense factors are guaranteed by life insurance companies that sell both regular life insurance contracts and variable annuities, certain inequities may develop adversely affecting other policyholders.

While there are other arguments both in favor of and opposed to the idea of variable annuities, the Subcommittee felt that these were of the greatest import.

In this connection it may be observed that recognized leaders in the industry are found on either side of the question. So divided is this opinion, that the trade associations in the life insurance field thus far have been unable to come forward with any concrete recommendations toward the solution of this problem.

After careful study, the Subcommittee recommends, that this association take no action either approving or disapproving the sale of variable annuities by life insurance companies at this time.

However, if any state permits the sale of variable annuities, it is recommended that such approval be conditioned upon the enactment of special legislation that will embody safeguards to protect the public. Such provisions should be drawn after due consideration of the following:

1. whether variable annuities should be sold only by a separate and distinct company or whether their sale should be permitted by life insurance companies. In this connection, a majority of the Subcommittee believes it more desirable to limit the sale of such contracts to separate and distinct companies limited to such activity;

2. that a balance between fixed dollar income and variable annuities should be achieved and maintained;

3. regulation and establishment of standards for investments should be carefully spelled out to include, but not be limited to, the following:

(a) prohibit investment in the common stock of any insurance company, national, state bank, or trust company;

(b) limit investment in common stock or shares of any corporation, joint stock association, or business trust in an amount not in excess of three percent of its total issued and outstanding common stock or shares of such corporation, association or trust;

(c) prohibit investment in shares of common stock unless the earnings available for dividends of the issuing corporation meet prescribed standards and provided further that the corporation has maintained an earning or dividend record for a specified number of years;

165 SEMI-ANNUAL MEETING

(d) outlaw investment in any common stocks or shares which at the time of investment are not registered on a national securities exchange as provided in an Act of Congress of the United States entitled "Securities Exchange Act" of 1934, approved June 6, 1934, as amended;

(e) prohibit conflicts of interest including any between officers and directors of the variable annuity company and the corporation whose stock is purchased;

4. supervision over the company including the issuance and sale of variable annuity contracts should come under the jurisdiction of the state insurance department;

5. standards should be prescribed for contract forms and applications therefor which cannot be used until the insurance department has approved them;

6. the corporation should report annually to all variable annuitants after the text and format of such report has been approved by the commissioner;

7. the corporation should be subject to statutes prohibiting discrimination, misrepresentation, estimate of prospective benefits, and the Unfair Trade Practice Act;

8. in order that purchase of variable annuities should not be used as a means of stock market speculation, payment of cash values in a lump sum should be prohibited and instead, payment disbursed over a reasonable period of not less than three to five years;

9. consideration should be given to limitation of expenses.

10. in case of stock insurance companies issuing variable annuity contracts, there should be a provision strictly limiting net earnings including realized and unrealized profits, allocable to stockholders;

11. companies should be subject to all of the procedural provisions of the insurance law with which life insurance companies must comply, including requirements as to examination, audit of reports, service of process, voucher requirement, liquidation, etc.;

12. prohibit the borrowing of money or hypothecation of assets.

With the rendition of the report, the Subcommittee requests that it *[be discharged.]* (continue to serve at the pleasure of the Life Insurance Committee.)

* Matter in [brackets] deleted and matter in (parentheses) added. See pages 152; 167.